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No. 86-261

In The

Supreme Court of the United States

October Term, 1986

GARFIELD TRUST COMPANY,

Appellant,

v.

DIRECTOR, DIVISION OF TAXATION,

Appellee.

On Appeal From The Supreme Court of New Jersey

BRIEF IN SUPPORT OF JURISDICTIONAL STATEMENT BY SUMMIT AND ELIZABETH TRUST COMPANY, NEW JERSEY NATIONAL BANK, THE RAMAPO BANK, PILGRIM STATE BANK, THE CHATHAM TRUST COMPANY, MAPLEWOOD BANK AND TRUST COMPANY, OCEAN COUNTY NATIONAL BANK, AMBOY-MADISON NATIONAL BANK, AND THE TOWN & COUNTRY BANK, AS AMICI CURIAE

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—o—

Amici Curiae urge this Court to note probable jurisdiction and reverse the decision below for the reasons set forth in the Jurisdictional Statement of Appellant (hereinafter referred to as "JS"; pages therein are hereinafter referred as to "JS. p. —", or JS Appendix, p. —a"), and for the reasons hereinafter set forth.

The Jurisdictional Statement correctly sets forth the Opinions Below, Jurisdiction, Constitutional Provisions and Statutes Involved, and Statement of the Case.

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INTEREST OF AMICI CURIAE

The following national banks and New Jersey State banks ("Amici Curiae") all operate in the State of New Jersey and are subject to the New Jersey Corporation Business Tax, N.J.S.A. 54:10A-1 to -40 ("CBT"), the interpretation of which by the New Jersey Supreme Court is the subject of this appeal by Garfield Trust Company, Appellant:

Summit and Elizabeth Trust Company

New Jersey National Bank

The Ramapo Bank

Pilgrim State Bank

The Chatham Trust Company

Maplewood Bank and Trust Company

Ocean County National Bank

Amboy-Madison National Bank

The Town & Country Bank

Like the Appellant, Amici Curiae invest in U. S. Treasury bonds and other federal obligations and derive income from such obligations. Amici Curiae participated as *amici curiae* in the case below, before both the New Jersey Superior Court, Appellate Division, and the Supreme Court of New Jersey. Amici Curiae respectfully urge the Court

to note probable jurisdiction and reverse the decision below, thereby preserving the investment attractiveness of federal obligations to corporate taxpayers subject to the New Jersey CBT and similar taxes imposed by other states.

SUMMARY OF ARGUMENT

The Court should note probable jurisdiction and decide this appeal because it involves intolerable state interference with the exercise of the federal Borrowing Power, an expressly enumerated Constitutional power of the highest importance, U.S. CONST., Art. I, § 8, cl. 2, and because the important federal questions presented by this appeal have not been previously reviewed by any federal court. The Court cannot entrust the state supreme courts with the final resolution of the issues presented by this appeal because the state interest involved, namely raising revenue through taxation which includes income from federal obligations in the computation of such taxation, is inherently in competition with the federal interests at stake which it is the duty of the state courts and this Court to protect pursuant to the Supremacy Clause, U.S. CONST., Art. VI, cl. 2.

ARGUMENT

I. THIS COURT SHOULD NOTE PROBABLE JURISDICTION AND DECIDE THIS CASE BECAUSE OF THE SUBSTANTIAL FEDERAL INTEREST AT STAKE, AND BECAUSE THE PROTECTION OF SUCH INTEREST DEPENDS UPON WHAT A FRANCHISE TAX IS FOR IMMUNITY PURPOSES, WHICH FUNDAMENTAL QUESTION REMAINS UNRESOLVED IN SPITE OF OVER TWO HUNDRED YEARS OF JUDICIAL SCRUTINY OF SUCH TAXES

A. The Federal Interest Embodied in The Federal Public Debt Statute is to Enable the Federal Government to Borrow Money Without Being Unduly Burdened by State Taxation.

The Federal Public Debt Statute, Rev. Stat. § 3701, 31 U.S.C. § 742 (*amended and recodified* as 31 U.S.C. § 3124 (a)) (hereinafter "§ 3701") was enacted by Congress to carry out the federal interest of enabling Congress to exercise its Constitutional Borrowing Power without undue burden from state taxation. *Memphis Bank and Trust Co. v. Garner*, 459 U.S. 392, 396, 103 S.Ct. 692, 695, 74 L.Ed.2d 562 (1983). The 1959 amendment to § 3701 was intended to clarify and broaden significantly the reach of statutory immunity to coincide with (but not be broader than) the full measure of Constitutional protection of federal obligations from state taxation. *American Bank and Trust Co. v. Dallas County*, 463 U.S. 855, 864, 103 S.Ct. 3369, 3375, 77 L.Ed.2d 1072 (1983); *First National Bank of Atlanta v. Bartow County Board of Assessors*, 470 U.S. —, 105 S.Ct. 1516, 1522 (1985).

As this Court stated in *American Bank*, 463 U.S. at 862, 103 S.Ct. at 3374, in amending § 3701 in 1959, Congress intended to set aside and reject legal formalisms which

did not provide meaningful assistance in properly determining which State taxes constituted undue burdens on the Borrowing Power. Specifically, Congress rejected old distinctions (such as (a) direct versus indirect taxes, (b) legal incidence versus economic incidence of taxation, and (c) property taxes, *i.e.*, taxes "on" property interests, versus "nonproperty" taxes, *i.e.*, taxes on privileges or exercises of powers "with respect to" or "measured by" property interests) as not providing meaningful assistance in protecting the immunity of federal obligations. *Id.*, 463 U.S. at 867, 103 S.Ct. at 3377.

A state tax which includes federal obligations in the computation of the tax constitutes an intolerable burden on the federal Borrowing Power if the tax threatens to diminish the value of federal obligations, *American Bank*, 463 U.S. at 870, 103 S.Ct. at 3378-79, that is, to diminish in the slightest degree the investment attractiveness of federal obligations to potential investors. *Memphis Bank*, 459 U.S. at 396, 103 S.Ct. at 695. It is undeniable that the imposition of an income tax or a net income tax which includes income from federal obligations will have a significant adverse economic impact upon the investment attractiveness of such federal obligations. Such adverse impact increases as the tax rate increases. The impact will also be the same whether such a tax can be said to be imposed "on" or "measured by" such income or net income.

Amici Curiae do not contend that a state tax violates § 3701 in *every* case where a part of the economic impact of the tax may be said to bear indirectly upon federal obligations included in the computation of the tax. As noted by this Court in *American Bank*, 463 U.S. at 864, 103

S.Ct. at 3375, Congress must have believed that franchise taxes and other taxes which are expressly permitted exceptions in § 3701 could include indirect consideration of federal obligations in the computation of the tax. On the other hand, this does not mean that it is necessary to permit *all* measures of indirect taxes to include the value of income of federal obligations in the computation of such taxes. The proper inquiry therefore is *what type of economic impact* is permissible under the indirect tax exceptions enumerated in § 3701.

Appellee argued before the Court below that there are no Constitutional immunity limitations on the measure of a state tax so long as the tax is denominated as an indirect tax. Appendix, pp. 5a, 6a. The Court below adopted this legal principle, thus extending the indirect tax fiction to a net income measure. JS Appendix, p. 8a. Such extension fails to take into account the fact that a tax measured by net income has a Constitutionally impermissible economic impact on federal obligations because such a measure, unlike the net asset type of measure considered in *Werner Machine Co. v. Director of Division of Taxation*, 350 U.S. 492, 76 S.Ct. 534, 100 L.Ed. 634 (1956), *aff'g Werner Machine Co. v. Director of Division of Taxation*, 17 N.J. 121 (1954), diminishes the investment attractiveness of federal obligations, both in the absolute sense and relative to other possible forms of investment (*e.g.*, commercial real estate, oil and gas, or other investments).

§ 3701 as amended in 1959 does not permit *all* forms of indirect taxation to include federal obligations, but only those taxes specifically named as exceptions in the statute. These exceptions in turn must be interpreted in a way which does not diminish the investment attractiveness of federal obligations, since such a principle of construction

is consistent with the legislative history of the 1959 amendment to § 3701 and consistent with the federal interest involved.

Department of the Treasury figures indicate that as of September, 1985, corporations (including banks but excluding insurance companies) held $253.4 billion in federal obligations (of which commercial banks held $196.9 billion).[1] State revenues from corporation net income taxes are increasing, with 46 States deriving $17.64 billion in revenues from such taxes in 1985.[2] The questions presented by this appeal are therefore of utmost importance to the federal government, particularly in these times of soaring federal deficits and ever-increasing federal public debt.

Because of the very strong federal interest and the huge amounts involved here, this Court should not lightly decide to dismiss this appeal from a state court decision which extends the outmoded pre-1959 *Werner Machine* formalisms to a state tax measured by net income.[3] Dis-

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1 See Bureau of Gov't Financial Operations, Office of the Secretary, U.S. Dep't of Treasury, Treasury Bulletin 30 (4th Quarter FY 1985).

2 U.S. Bureau of the Census, *State Government Tax Collections in 1985*, Series GF85, No. 1, pp. V, VI. This Report includes in the category of "corporation net income taxes" all taxes on corporations and unincorporated businesses (when taxed distinctively from individual income) measured by net income, and, interestingly, states that such taxes are so classified in the Report even if they may be called "license" or "franchise taxes" if the taxes are measured by net income. *Id.*, at 34.

3 As this Court said in another context:

> There is no economic consequence that follows necessarily from the use of the particular words, "privilege of doing business," and a focus on that formalism merely obscures the question whether the tax produces a forbidden effect.

(Continued on following page)

missal of this appeal would encourage states to adopt and/or increase the rates of such taxes which consider income from federal obligations in their computations.

B. This Appeal Presents Fundamental Issues Never Before Decided by any Federal Court.

Although this appeal involves substantial federal statutory and Constitutional interests, this case has thus far been litigated solely in the courts of the State of New Jersey. The Court below considered and disposed of Appellant's contentions concerning interpretation of state statutes which would have resulted in a finding that the CBT discriminated against federal obligations.[4]

With respect to the issues raised by this appeal, the Court below held that the CBT constitutes a *bona fide* fran-

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Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 288, 97 S.Ct. 1076, 1084, 51 L.Ed.2d 326 (1977). *Complete Auto Transit* did not involve immunity questions, but rather the question of permissible state taxation under the Constitution's Commerce Clause. The Court's method, however, is instructive, since it rejected a previous leading case which, like *Werner Machine*, had exalted form over substance in state tax matters involving federal constitutional questions, and examined the nature of the underlying federal interest in order to become free from adherence to an abstract rule which served no meaningful purpose. As the Court stated: "The reason for attaching constitutional significance to a semantic difference is difficult to discern." *Id.*, 430 U.S. at 285, 97 S.Ct. at 1082.

[4] The Appellant also contended below that the CBT was impermissibly discriminatory if it included federal obligations but excluded certain state and local obligations from the measures of the CBT by virtue of the language of certain state enabling statutes. In interpreting the broad tax exemption provisions of the state enabling statutes as not requiring exemption of the state and local obligations from the CBT, however, the Court below foreclosed a § 3701 discrimination argument by the Appellant here. JS Appendix, p. 18a.

chise tax for § 3701 immunity purposes. As discussed in the Jurisdictional Statement, in reaching that conclusion the Court below dealt in a cursory manner with the issue whether the CBT constitutes a "franchise tax" for § 3701 purposes. Since no issue of discrimination is presented by this case, this appeal therefore squarely presents to the Court the question whether the CBT is a permissible "franchise tax" under § 3701.

The Court below appears to justify its summary treatment of the "franchise tax" issue by pretending that the issue has been disposed of by prior decisions of this Court, namely *Werner Machine, American Bank* and *Memphis Bank*. JS Appendix, p. 10a. However, in relying upon *American Bank* and *Memphis Bank,* the Court below ignored the fact that neither of those cases ever reached the question of what constitutes a "franchise tax" for § 3701 purposes. The tax in *American Bank* did not even purport to be a franchise tax, and the tax in *Memphis Bank* was held to be discriminatory, thus leaving unresolved the question of what constitutes a franchise tax for § 3701 purposes. *Id.*, 459 U.S. at 396, 103 S.Ct. at 695, n.6.

It is important to note that although the Appellant and all of Amici Curiae are commercial banks, *the CBT is a state tax applicable to corporations generally and is not a bank tax* even though banks tend to be the primary holders of federal obligations. This point was emphasized by Appellee in oral argument before the Court below and is not an issue in this case. Appendix, p. 12a. For this reason, the reliance of the Court below upon *Tradesmens National Bank of Oklahoma v. Oklahoma Tax Comm'n,* 309 U.S. 560, 60 S.Ct. 688, 84 L.Ed. 947 (1940), is improper

since that case did not involve an immunity challenge under § 3701.[5]

It is therefore respectfully submitted that this Court should not allow the cursory analysis of the Court below to determine the law of the land on this issue. This Court should instead note probable jurisdiction and provide full review of the important federal issues presented by this appeal.

II. THE STATE SUPREME COURTS CANNOT BE ENTRUSTED WITH THE FINAL RESOLUTION OF THE ISSUES PRESENTED BY THIS CASE BECAUSE THE INTEREST OF THE STATES IN TAXING CORPORATIONS COMPETES WITH AND IS AT ODDS WITH THE FEDERAL INTEREST OF TAX EXEMPTION FOR INVESTMENTS IN FEDERAL OBLIGATIONS WHICH FEDERAL INTEREST IT IS THE DUTY OF THIS COURT TO PROTECT

A. The State Interest in Enhancing its Revenue Base Creates Inherent Pressure on State Courts to Find that Income from Federal Obligations is Includible in the Computation of State Corporation Taxes Measured by Net Income.

With the decision in *American Bank* and the consequent demise of the bank shares tax as an exception to the express prohibitions of § 3701, so-called franchise taxes will soon become (if they have not already become) the preva-

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[5] Amici Curiae do not contend that states may not impose taxes measured by net income on national banks; such taxes are arguably permissible under Rev. Stat. § 5219, 12 U.S.C. § 548 ("§ 5219"). As this Court held in *American Bank*, however, any state tax on corporations measured by net income must satisfy the requirements of § 3701, even if banks are subject to such tax and therefore § 5219 is also applicable. *Id.*, 463 U.S. at 873, 103 S.Ct. at 3380.

lent form of state taxation of corporations. And given the natural desire of state government to preserve and develop ways to increase its revenue base, the measure of such so-called franchise taxes will undoubtedly be linked to the source of the corporation's own revenue base, its income. At least twenty-six states (and the number may well be more) have now enacted so-called franchise taxes that are measured by the net income of corporations.[6]

The growing dominance of this form of taxation should be a matter of grave concern for this Court, for given the fact that the essential nature of such taxes is economically indistinguishable from income taxes labeled as such, the Constitutional protection of investments in federal obligations so carefully crafted by Congress in § 3701 will be defeated.

The inability of the state supreme courts to consider fairly the federal interest of tax exemption of federal obligations in light of the important state interest in revenue collection provides all the more reason why this Court should accept this case for review and finally determine the true nature of a franchise tax for immunity purposes. Particularly telling of this inability of the state courts to resolve this issue is the epic of the Montana corporate tax. In *First Federal Savings & Loan Association v. Department of Revenue*, 200 Mont. 358, 654 P.2d 496 (1982), *cert.*

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[6] Alabama, Alaska, Arkansas, California, Connecticut, Delaware, Florida, Hawaii, Idaho, Iowa, Louisiana, Maine, Massachusetts, Minnesota, New Jersey, North Dakota, Ohio, Oklahoma, Rhode Island, South Dakota, Texas, Utah, Vermont, West Virginia, Wisconsin, and Wyoming. *See* Blasi and Joyce, *The Franchise Tax Exception to the Federal Exemption Statute*, 1985 BANKING L.J. 462, 474-77.

denied, 462 U.S. 1144, 103 S.Ct. 3128, 77 L.Ed.2d 1378 (1983), *rev'd., Schwinden v. Burlington Northern*, 691 P.2d 1351 (Mont. 1984), the Montana Supreme Court initially held that the state's argument (that the franchise tax measured by net income was a tax on the privilege of doing business and not a tax on the income) presented a "distinction without a difference". 654 P.2d at 498. The court went on to hold that the corporate tax therefore violated § 3701 by requiring the inclusion of federal obligations in the calculation of the tax. In its subsequent decision, involving an amendment to the corporate tax (whereby the Montana legislature had established a formula for reducing proportional deductions related to tax exempt income), the Montana Supreme Court struck down the amendment, reasoning that the decision in *First Federal* so required, and then "in the same breath" proceeded to review anew that case, ultimately holding it was wrongly decided and that the Montana corporate tax, though measured by net income, did not violate § 3701. 691 P.2d at 1358-59. Rather than a carefully considered analysis (and in spite of a proffered disclaimer as to any motive relating to loss of revenue), this latter decision reads more like an apology to the people of Montana, and to the state and county governments in particular, for the turmoil caused by the court's initial decision and the consequent loss of revenue to the state. *Ibid.*

The moral of the Montana decisions (and other state supreme court decisions on this issue) is clear—"every state for itself"—leaving this Court as the sole protector of the federal interest embodied in § 3701. And the manner in which the New Jersey Supreme Court "analyzed" the nature of the corporate tax in this case only adds to the

urgency that has now come to exist on a nationwide basis for this Court to determine whether § 3701 permits a corporate tax measured by net income to qualify as a franchise tax.

B. The Decision of the Court Below was Erroneous Because it was Incorrectly Motivated by a Bias Toward State Revenue Raising Which Bias in Effect Created a Presumption of Taxability of Federal Obligations in Substitution for the Constitutionally Required Presumption of Immunity under § 3701

The decision of the Court below involved substantial questions concerning the exemption under various state statutes for state agency and local government obligations and for the income from such obligations from inclusion in the CBT tax computations.[7] Although the decision below with respect to interpretation of the state enabling statutes is not subject to review by this Court, it is submitted that the approach taken by the Court below in its construction of the state enabling statutes as related to the CBT is instructive to this Court because it is remarkably similar to that Court's handling of § 3701 as it relates to the CBT.

Both the state enabling legislation and § 3701 contain broad immunity from state taxation and, like § 3701, several of the state enabling statutes even contain a few specifically expressed exceptions to the broad exemptions.[8] The statutory language of the CBT, by contrast, does not expressly require inclusion of either state or federal obli-

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[7] See JS Appendix, p. 11a.

[8] See JS Appendix, pp. 11a, 12a, for language of state board of education and EDA immunity statutes.

gations (or income thereon), such inclusion being solely the result of administrative interpretations.[9]

Notwithstanding the clearly expressed legislative intentions to provide broad immunity from state taxation contained in both the state enabling statutes and § 3701 in order to enhance investment attractiveness of these state and federal obligations, and despite the lack of legislative direction to include state and federal obligations, including income thereon, in the CBT calculations,[10] the Court below apparently found that it was the state immunity statutes rather than the CBT which were ambiguous, and then proceeded to misapply various principles of statutory construction in interpreting the immunity statutes.[11]

The Appellee contended in oral argument that there should be an inference in favor of upholding taxability, stating that a contrary decision would be unwise "from an economical point of view" (Appendix, p. 10a), inviting a question from the Court below concerning the amount in-

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[9] See JS Appendix, p. 12a (including n. 7, which is the first place in its opinion where the Court reveals its own awareness that inclusion of income from federal obligations in the CBT is an administrative interpretation and not statutorily required).

[10] Proof of the ambiguity of the CBT definition of "entire net income" is the conclusion of the Attorney General of New Jersey in 7 Formal Op. N. J. Atty. General (1977), at p. 2, that income from EDA obligations is exempt from the Corporation Income Tax even though the definition of "entire net income" in that tax (see N.J.S.A. 54:10E-4(i), set forth in Appendix, pp. 18a-20a) is virtually identical to the CBT definition of that same phrase (see N.J.S.A. 54:10A-4(k), set forth in JS Appendix, pp. 44a-47a).

[11] The Court below misapplied a principle that the exemption provisions of the enabling statutes should be strictly construed, even though the broad exemptions were not contained in the CBT but rather in separate enabling legislation which

(Continued on following page)

volved (Appendix, pp. 10a-12a), and then providing the Court below with totally unsupported revenue loss projections, even noting that the projected losses would result "primarily [from] the federal obligations" in the event of a decision upholding exemption.[12]

Despite the fact that consideration of the revenue impact of its decision was totally irrelevant to sound statutory construction of the statutes before it, the Court below decided that protection of the state's revenue base was a significant justification for refusing to give effect to the state enabling statutes. JS Appendix, p. 17a. The fact that the Court below considered the amount of potential revenue loss relevant to its interpretation of the state enabling statutes is also to be inferred from its denial of the motion of Amici Curiae to strike the Appellee's statements from the record of the oral argument. (See text of motion and letter brief at Appendix, pp. 14a-17a. The Court's denial of the motion, in the context of its revenue motivation, is at JS Appendix, p. 17a, n.9.)

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clearly had broad purposes other than raising revenue. (See JS Appendix, p. 17a; see also discussion at oral argument, Appendix, pp. 8a-10a.) The Court below also misapplied a principle favoring constitutionality of an ambiguous statute, by ignoring the plain and unambiguous exemptive language of the enabling statutes (JS Appendix, p. 16a.), despite the contentions of Amici Curiae that the ambiguous CBT should be construed to require exemption for both state and federal obligations and income.

[12] Appendix, p. 12a. The Appellee compounded these prejudicial remarks in failing to qualify the revenue loss projections by properly advising the Court of the substantial impact which application of a formula disallowing deductions for expenses related to tax exempt income might have upon the projected losses, even though the Appellee contends such a formula would be applicable. (See JS, p. 4, n.3.)

These misapplications of principles of statutory construction by the Court below created a strict construction favoring inclusion in the CBT net income base of income from not only state obligations but also federal obligations. Such a presumption is totally unjustifiable given the clearly expressed legislative intentions in both the state and federal statutes favoring tax exemption.

While the state court's analysis of the state enabling statutes is not subject to review here, it is important to note that that analysis effectively predetermined the § 3701 issues, making a mockery of the federal interest embodied in § 3701 which the Court below was obligated to evaluate in a meaningful way *independently* of the state interest. The structure of §3701 as amended in 1959 is to create a broad exemption with narrow exceptions. Since the Supremacy Clause demands that the state's interest in raising tax revenues be subordinated to the federal Borrowing Power, the Court below improperly stands §3701 on its head when it attempts to favor taxability of federal obligations by the State of New Jersey. The only proper construction of §3701 is that the state tax exceptions to general immunity must be strictly construed against the state imposing the tax, and such state has the burden of demonstrating that such tax comes within an express exception to the general prohibition of §3701. *U.S. v. First City National Bank*, 386 U.S. 361, 366, 87 S. Ct. 1088, 1092 (1967). The Court below totally failed to consider the relationship between the taxability of income from federal obligations and the investment attractiveness of such obligations. This is surprising since the Court below was surely aware, and the Appellee has conceded, that taxation of income from governmental obligations impaired their

investment attractiveness.[13] The CBT thus constitutes an unconstitutional form of economic incidence.

This Court should therefore review the decision below because it is tainted by a bias in favor of state revenue considerations which are not only irrelevant to the proper construction of the state enabling statutes but, more importantly here, are in direct conflict with the federal Borrowing Power and § 3701.

CONCLUSION

The decision below violates the immunity from state taxation guaranteed by Congress in §3701 and explained by the Court in *American Bank, supra.* This attempt to circumvent the plain language of §3701 and the federal interests embodied therein is a grave threat to the federal Borrowing Power. This Court must correct the error of the decision below in order to protect the federal Borrowing Power. For the foregoing reasons and the reasons contained in the Jurisdictional Statement of Appellant, probable jurisdiction should be noted and the decision below should be reversed.

Respectfully submitted.

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[13] See discussion at oral argument below, Appendix, pp. 8a-11a.

APPENDIX

In the
SUPREME COURT OF NEW JERSEY
TRENTON, NEW JERSEY

Docket No. A-85-85 [sic]

GARFIELD TRUST COMPANY,
Plaintiff-Appellant,

-vs-

DIRECTOR, DIVISION OF TAXATION,
Defendant-Respondent.

TRANSCRIPT OF PROCEEDINGS

January 22, 1986

IN ATTENDANCE:

JUSTICE ROBERT L. CLIFFORD, Presiding
JUSTICE ALAN B. HANDLER
JUSTICE STEWART POLLACK
JUSTICE DANIEL O'HERN
JUSTICE MARIE GARIBALDI
JUSTICE GARY STEIN

APPEARANCES:

GLENN T. LEONARD. ESQ., for Plaintiff-Appellant

HARRY HAUSHALTER, D.A.G., for Defendant-Respendent

WILLIAM S. ROBERTSON, III, ESQ., for Amicus Curiae, Summit and Elizabeth Trust Co. [sic]

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(p. 2) JUSTICE CLIFFORD: I'll call up A-85, Garfield Trust Company against Director, Division of Taxations [sic].

[Oral arguments on behalf of Appellant and Amici Curiae are omitted]

* * *

(p. 21) Mr. Haushalter?

MR. HAUSHALTER: May it please the Court. I would like initially just to indicate what additional issues that remain in this case because of the bifurcation of this case at the trial level. I should note that the bifurcation which really at the suggestion of Mr. Leonard. We were ready to try the ease with all of our witnesses, but Mr. Leonard indicated at the time that it was his understanding that just the basic issue of the excludability or includability of these debt obligations would be considered.

(p. 22) The issues essentially are three fold that were not reached by the trial Court and would have to, I, I would imagine, be reached by the trial Court on a remand should the taxpayer be successful—that is the issue of the computation of the refund, particularly based on the Barto [sic: Bartow] decision; there would be the issue of prospectivity or retroactivity, because we're dealing here with substantial tax revenues which may amount to a hundred million dollars and we may be dealing with another solario (sic) decision; and the third issue is the issue of the constitutionality of these save harmless. The same harmless issue was not briefed by us, it was not necessary to brief it, it was not addressed by the trial court because of the way this case was decided.

Let me indicate to the Court some of the major and significant flaws in the arguments by both the taxpayer and the amicae [sic]. First of all, it was very kind of Mr. Robertson to advise the Court of it's [sic] decision in silent Hoist, but he—if Mr. Robertson leaped through the ad-

vance sheets a little bit further he would have come to ABCO [sic] Financial, a decision also authored by Justice O'Hern, in which I think the court more appropriately noted in page 31, it states, "to understand the tax," and this is the CBT, "we must recall the history of State taxation of Interstate Commerce. Prior to 1973 New (p. 23) Jersey had only a franchise tax, although one of it's [sic] components was value measured by income."

Essentially what Mr. Robertson is indicating to the Court is you cannot have a tax, a franchise tax, a so-called indirect tax, measured by income. There is no treatise, there is no law review, there's no decision by any Court that I've seen or that's been suggested by the parties that states that, that principal [sic]. In fact we have a decision by the U.S. Supreme Court, Tradesman [sic] National Bank of Oklahoma City versus Oklahoma Tax Commission, reported at 84 Lawyer's Edition, 947. It's a case that Mr. Robertson says includes dictum. The Court, in page 209, states, the "power of a state to levy a tax on a legitimate subject such as a franchise measured by net assets or net income, including tax exempt federal instrumentalities or their income, is likewise well settled."

I think it's important to bring this up because it obviously deals with the, the primary issue in this case which is the continuing viability of Werner Machine. The contention is that Werner Machine has no longer any meaning, and therefore, this concept of an indirect tax is fiction, it shouldn't be considered by this Court, let's just look at the ultimate economic impact. I maintain that the Supreme Court in the Werner Machine case (p. 24) very well knew that there would be an economic impact on the so-called exempt debt obligations. It said so. Nevertheless, it held to the so-called fiction, and it's a fiction that

really is not a fiction because it has a very very significant meaning, it has tremendous economic impact and it's not an issue that a court should just cavelierly [sic] dismiss. The concept of a franchise tax was discussed in some detail by this Court in the Werner Machine case, and it talks about—it says, "under the statute the taxes imposed upon the corporation for the privilege of having or exercising it's [sic] corporate franchise in this state, or for the privilege of doing business, employing or owning capital or property or maintaining an office in this state." Those same basies [sic], those triggering basies [sic] for the tax, are still there today. They were there when the income tax, measure of the tax was enacted. In addition, the Court says, "dissolution, merger, consolidation or withdrawal of authority to exercise the corporate franchise is forbidden unless, unless the tax is paid. Foreign corporations are subjected to revocation of authority to do business in this state in the event of a failure to pay the tax, and domestic corporations are subject to forefiture [sic] of their charters in the event of failing to pay the tax. We find nothing in the statute indicative of a tax (p. 25) upon the property owned by the corporation, nor upon a franchisee's property."

Nothing has changed with regard to the tax as a result of the income measure being enacted. It's the same tax. For purposes of revenue raising, the legislature, in it's [sic] ultimate wisdom, decided to add this measure. It's a much more equitable measure with regard to corporate taxpayers, and why not do it? All the other states do it. All of the cases that we cited which have dealt with this issue—the Alaska case, the Connecticut case, the Massachusetts case—those are all income tax cases and those all are franchise matters.

THE COURT: Are there practical differences in terms of the constitutional limits of such a tax or it's [sic] application that turn on whether it's direct or indirect? In terms of such things as allocation and inclusion?

MR. HAUSHALTER: No. I, I think from that vantage point—probably I may be wrong because I haven't fully considered that question, but just at it's [sic] face value I would say probably not, because we see the identical type of provisions under the CIT as we have in the CBT.

THE COURT: I had an impression, not really crystallized in my own mind, that with respect to, for example, the taxability of particular property owned by a corporation—what might be taxable or included in a tax might well (p. 26) be different if it's a direct tax as opposed to a tax that is simply measured by property or net worth. Similarly with respect to income—such things as physical locus and, and concepts like that might well be different if you're dealing with a direct tax as opposed to a tax that's merely measured by, by —

MR. HAUSHALTER: Well I would say, your Honor, and I'm not sure whether this has constitutional implications - it's very important, I think conceptually to keep in mind that when you're talking about an indirect tax you're talking about A, an activity that's being taxed, namely the exercise of a franchise doing business; and, B, how you measure the tax. We have a whole slew of variations that are possible for our legislature to adopt.

When you're talking about a direct tax you're really limited to using that same tax as both the incidents [sic] and the measure, so in a sense you're, you're restricting

your, your variations of measuring when you're talking about a so-called direct tax. When you're talking about a property tax, it's a direct ad valorem tax, you're stuck with the property itself as the base. With an income tax, although if you read Hellerstein and some of the other treatises, they claim an income tax as sort of a hybrid - at times an income tax may be a direct tax on the income, other times it may be something else, (p. 27) it may be a tax that is used as a measure with regard to assessing some other kind of activity. But obviously the, the important constitutional issue that we're dealing here with today is, is significant and it does make a difference whether we're talking about an indirect or a direct tax, and if we look at the, the subjectivity provision of the CIT tax, it talks about some kind of income earned in the state. That is the, the excise that is being taxed and is being measured by the income. There is no franchise there. That's not an indirect tax, and, therefore, our opinion dealing with the EDA bonds had to be structured that way. We're realing with a completely different animal. And, and that recognition is something that's really part of our tax system, and it's been recognized by the U.S. Supreme Court and by this Court, and we—as I indicated earlier, this cannot just be cavalerly [sic] dismissed as a fiction, it has too much importance. And when we now come into the so-called allegation of a conflict which I really feel is, is quite inappropriate to say that there is no conflict—the conflict is there very clearly, No. 1, because our CBT does and has always taxed the principal and the income from federal obligations. The taxing statute itself, if we look to N.J.S.A. 54:10A-4K and paragraphs, sub paragraphs A and B, A talks about the—well

I should say the (p. 28) initial definition of entire net income talks about the federal base, and then there are adjustments made, and the various adjustments talk about, No. 1, the amount of any specific exemption or credit allowed under any law of the United States imposing any tax or measured by the income of corporations. In other words this is an inclusion in the base outside of what the federal government may exempt. In addition to that, any part of any income from dividends or interest on any kind of stocks, securities or indebtedness except as provided in subsection K1, which is not relevant here. B is an all encompassing provision which brings into the entire income base all of these various income provisions that we're discussing here.

Since Werner Machine clearly established the taxability of federal obligations there's been no question that the federal income and the federal—the principal of these federal obligations is part of our tax basies [sic]. If we agree, if the Court were to agree with, with the, with my adversary that in fact the EDA and the local Board enabling provisions and all of the others exempt those provisions from the tax, then we have the conflict, the conflict being that our CDT [sic] taxes federal, federal obligations, but if it exempts these local or state obligations the discrimination is there. I don't disagree (p. 29) with the concept of the Memphis State [sic] case. We cannot discriminate. We cannot give a preference to these local provisions. We must treat them just like we do the federal provision. And the conflict is there and I, I think the appropriate provision or the appropriate resolution is the way the Alaska Court dealt with the problem in terms of harmonizing all of the tax statutes, and if it's clear, and it always has

been clear, that the federal obligations are part of the tax basies [sic], this Court must give the appropriate interpretation that we maintain is proper with regard to these local and state authorities. The legislature—

THE COURT: If the enabling legislation dealing with State obligations fairly read would suggest that these obligations, as well as income earned on these obligations, be excluded, then why wouldn't the harmonization take the form of excluding federal obligations and income earned on federal obligations?

MR. HAUSHALTER: Because, your Honor, I, I don't consider that harmonization. If in fact those types of income and, and the principal value of these obligations were always part of the tax, are clearly part of the tax, the Courts have said they are part of the tax—how can that be—

THE COURT: That, that, that much is true, but (p. 30) it doesn't necessarily follow that the legislature, in passing legislation creating other forms of state governmental obligations, intended that they would be taxed merely to avoid the otherwise discriminatory treatment of the federal obligations.

MR. HAUSHALTER: Your Honor, I, I think it's a, it's a very proper question. I can merely indicate to the Court that I feel that in this particular area had the legislature intended that, it certainly should have been crystal clear. We're, first of all, dealing with an exemption provision, although Mr. Robertson claims that it's an exemption provision outside the tax laws and the strict construction standards should not apply. I don't believe that's correct. But the legislature is really required to know—

it's inferred that the legislature be aware of this system. Why should it enact these enabling provisions and, and not, not indicate what it means with regard to the CBT?

THE COURT: Presumably the enabling legislation has something to do with, with making state obligations more marketable. more desirable, so that the overwhelming legislative intent might have, might have been to avoid the taxation of these obligations or income earned on these obligations.

Now if indirectly they become part of the measure (p. 31) of a tax so that taxpayers owning them have this indirect burden, doesn't that work at cross purposes with an original legislative intent to free them of any, of any form of taxation?

MR. HAUSHALTER: Well, your Honor, the word "any" is, is, is ambiguous there. The legislature can go as far as it wants to go. It it wants to go—I mean the, the critical facet of these tax exemption provisions was the, the federal, the federal tax. That's clear in the legislative history with regard to these provisions. That's the enticing facet of, of owning these, these type of obligations. The State aspect, I think, is, is relatively speaking, minimal. But we don't know. I mean it's conjecture. It becomes conjecture as to what the legislature may or may not have, and I don't think there's any impropriety in the legislature going up to a certain point and saying it's going to be exempt, these obligations are going to be exempt from A. B and C but not from the corporation tax.

THE COURT: Is there something to the proposition that, that the avoidance of a tax on these obligations or

income earned on these obligations is to make them generally more attractive in the market?

MR. HAUSHALTER: More attractive, yes.

THE COURT: More attractive.

(p. 32) MR. HAUSHALTER: More attractive.

THE COURT: And if that's the overriding purpose of such an exemption, why—and since we have to impute a legislative intent here, why is it more reasonable to impute an intent on the part of the legislature that these obligations should not be included in the measure of the franchise tax, rather that they, that they can and should be?

MR. HAUSHALTER: Well I think again if you're going—you're starting off at, at point zero. If you're talking about inferences, the inference ought to be in our favor, and, and that's really what your Honor is suggesting here—why shouldn't we infer that they meant to go all the way with these particular enabling exemptions and, and exempt them from the corporation business tax? I don't think that's proper statutory construction. I don't think it's, it's wise from an economical point of view. These are substantial—I mean there are substantial tax revenues involved here and we can't just surmise.

THE COURT: Yes, that, that—on the one hand, but the other, the down side aspect of the proposition is that to the extent they find their way into a measure of a tax, it, it discourages their marketability and, therefore, works as an inhibition with respect to the (p. 33) those governmental entities that have given rise to the obligations.

MR. HAUSHALTER: Your Honor, it's difficult to gauge the extent of, of the—what shall we say—the, the ability of, of investors to purchase these. What, what they are looking for, I think essentially, is the exemption with regard to federal taxation. When these prospectuses with regard to these various obligations are printed they always have a clause in there that these, these type of bonds and notes and so forth are not exempt from indirect tax such as corporation business tax. The investing public—banks and so forth—are still purchasing them. Obviously there was sufficient enticement in these provisions by virtue of the federal exemption that, that warranted the, this kind of an arrangement. And as I indicated, unless there is explicit language within these various enabling provisions, in light of the history of all of this, indicating that these types of, of obligations are exempt from the CBT, I believe it is the obligation of this Court to affirm the lower courts, that those decisions are correct. You cannot just casually infer this type of a significant exemption.

THE COURT: Mr. Haushalter, you mentioned that a lot of revenue is involved. Do you have any idea how much? Both on the federal obligations and the state (p. 34) and local?

MR. HAUSHALTER: The federal obligations are the primary revenue loss should we not prevail here. It's been estimated at about 100 million—we're talking about a two year statute refund if that were to be available, we're talking about maybe 30 to 40 million a year on a prospective basis.

I think it's important for the Court to know that—

THE COURT: 30 or 40 million annually?

MR. HAUSHALTER: Annually yes.

THE COURT: 100 million essentially is an estimate of a two year refund?

MR. HAUSHALTER: Two, two years and the current year, yes.

As I indicated we—

THE COURT: How about this State, the State and local side?

MR. HAUSHALTER: Well this is a complete, a complete amount. We don't have a specific breakdown in terms of—

THE COURT: I see. That, that includes both kinds of obligations.

MR. HAUSHALTER: Yes, but primarily the federal obligations.

I should note to the Court that this particular (p. 35) issue is not an issue that relates to banking corporations or financial institutions, although those type of institutions tend to be the primary holders of obligation. This is an issue that relates to every corporate entity that may be subject to CBT, and the attempt by amicae [sic] to color this as some sort of a banking issue is inappropriate it's incorrect. The issue is generic in terms of every corporate entity.

Thank you.

JUSTICE CLIFFORD: Thank you, Mr. Haushalter.

Any questions of Mr. Haushalter?

(NO RESPONSE)

JUSTICE CLIFFORD: Thank you, sir. We thank all counsel. The Court will reserve decision.

CERTIFICATION

I, ALBERT ADLER, a Transcriber approved by the Administrative Office of the Courts of New Jersey do hereby certify that the foregoing Transcript of Proceedings in the matter of Garfield Trust Company versus Director, Division of Taxation heard in the Supreme Court of New Jersey, Trenton, New Jersey on January 22, 1986 and recorded on Tape recording is true and accurate to the best of my knowledge and ability.

Dated: 9/5/86

/s/ Albert Adler

RM

SUPREME COURT OF
NEW JERSEY

Docket No. 24,295

GARFIELD TRUST COMPANY,

Plaintiff/Petitioner

vs.

DIRECTOR, DIVISION OF TAXATION,

Defendant/Respondent

CIVIL ACTION
NOTICE OF MOTION TO
STRIKE CERTAIN PORTIONS
OF ORAL ARGUMENT

on appeal from the Superior Court of New Jersey, Appellate Division (Docket No. A-5620-83T7, before Judges Pressler, Brody and Cohen)

TO: CECCHI AND POLITAN
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PLEASE TAKE NOTICE that Williams, Caliri, Miller and Otley, a Professional Corporation, on behalf of Amici Curiae in this case (hereinafter the "Movant"), hereby applies to the Supreme Court of New Jersey for an Order striking certain portions of Defendant/Respondent's oral argument before the Supreme Court on January 22, 1986. Movant makes this application upon the ground that certain statements made by counsel for Defendant/Respondent during said oral argument were improper, highly prejudicial, and totally unfounded on the record of this case.

A Letter Brief accompanies this Notice of Motion.

Respectfully submitted,
WILLIAMS, CALIRI, MILLER & OTLEY
A Professional Corporation
Attorneys for Amici Curiae

By: /s/ William S. Robertson, III

Dated: January 23, 1986

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January 23, 1986

Supreme Court of New Jersey
Hughes Justice Complex
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Trenton, New Jersey 08625

Re: LETTER BRIEF OF MOVANT AMICI CURIAE IN SUPPORT OF ITS MOTION TO STRIKE CERTAIN PORTIONS OF ORAL ARGUMENT in *Garfield Trust Company v. Director, Division of Taxation,*
Docket No. 24,295

STATEMENT OF FACTS

This case involves whether the New Jersey Corporation Business Tax ("CBT") requires the inclusion of the value and income of federal and certain state obligations in its calculation. On January 22, 1986, the respective parties to this case, including Amici Curiae, participated in oral argument before the Supreme Court, counsel for the Division of Taxation (the "Division") being the last to address the Court. During his oral argument, counsel for the Division noted that substantial sums of revenue were at stake in this case, and further stated that approximately $100,000,000.00 would have to be returned by the State of New Jersey to corporate taxpayers subject to the CBT if the Supreme Court were to decide this case in favor of Petitioner, Garfield Trust Company. The method by which this amount was calculated was not explained. This estimated amount was represented to the Court by Mr. Haushalter in connection with his contention that the weight or presumption should be in favor of taxability under the CBT, and against immunity under the enabling statutes, because of the large amount of potential CBT revenue loss involved.

LEGAL ARGUMENT

The amount of the potential refunds to all CBT corporate taxpayers in the event the Supreme Court decides this case in favor of Garfield Trust Company is irrelevant to the interpretation and meaning of the various enabling and tax statutes involved in this case. In addition, the estimate of that amount by the Division's counsel is not founded on and is not supported by any of the evidence or any other information constituting the record of this case. The particular statements by the Division's counsel were therefore improper and highly prejudicial, and should be stricken from any transcript of the oral argument, and should otherwise be ignored by the Supreme Court in its deliberations in this case.

Respectfully submitted:

WILLIAMS, CALIRI, MILLER & OTLEY
A Professional Corporation
Attorneys for Movant

By: /s/ William S. Robertson, III

NEW JERSEY CORPORATION INCOME TAX STATUTE

N.J.S.A. 54:10E-4. Definitions

For purposes of this act, unless the context requires a different meaning:

* * *

i. "Entire net income" means total net income from all sources, whether within or without the United States, and shall include the gain derived from the employment of capital or labor, or from both combined, as well as profit gained through a sale or conversion of capital assets. For the purpose of this act, the amount of a taxpayer's entire net income shall be deemed prima facie to be equal in amount to the taxable income, before net operating loss deduction and special deductions, which the taxpayer is required to report to the United States Treasury Department for the purpose of computing its Federal income tax; provided, however, that in the determination of such entire net income,

(1) Entire net income shall exclude 100% of dividends which were included in computing such taxable income for Federal income tax purposes, paid to the taxpayer by one or more subsidiaries owned by the taxpayer. For the purposes of this section, a subsidiary shall be deemed to be any corporation in which a taxpayer is the owner of at least 80% of the total combined voting power of all classes of stock entitled to vote and of at least 80% of each class, if any, of nonvoting stock. With respect to other dividends, entire net income shall not include 50% of the total included in computing such taxable income for Federal income tax purposes;

(2) Entire net income shall be determined without the exclusion, deduction or credit of:

(a) the amount of any specific exemption or credit allowed in any law of the United States imposing any tax on or measured by the income of corporations;

(b) any part of any income from dividends or interest on any kind of stock, securities or indebtedness, except as provided in subsection i. (1) of this section;

(c) taxes paid or accrued to the United States on or measured by profits or income, or the tax imposed by this act, or any tax paid or accrued with respect to subsidiary dividends excluded from entire net income as provided in subsection i. (1) of this section;

(d) net operating losses sustained during any year or period other than that covered by the report;

(e) 90% of interest on indebtedness owing directly or indirectly to holders of 10% or more of the aggregate outstanding shares of the taxpayer's capital stock of all classes; except that such interest may, in any event, be deducted. [sic]

(i) up to an amount not exceeding $1,000.00;

(ii) in full to the extent that it relates to bonds or other evidences of indebtedness issued, with stock, pursuant to a bona fide plan of reorganization, to persons, who, prior to such reorganization, were bona fide creditors of the corporation or its predecessors, but were not stockholders or shareholders thereof;

(3) The director may, whenever necessary to properly reflect the entire net income of any taxpayer, determine the year or period in which any item of income or deduction shall be included, without being limited to the method of accounting employed by the taxpayer.

* * *